

TEST YOURSELF ON STOCKHOLDERS' EQUITY: PAID-IN CAPITAL

True or False

For each of the following statements, circle the T or the F to indicate whether the statement is true or false.

- T F 1. Any individual stockholder in a corporation may personally be held liable for all debts incurred by the corporation.
- T F 2. A corporation has continuity of existence which permits the business to continue regardless of changes in ownership or the death of a stockholder.
- T F 3. A stockholder in a corporation does not have the right to transact corporate business or to intervene in the management of the business.
- T F 4. Stockholders of a corporation elect the board of directors, who in turn appoint the top officers of the corporation.
- T F 5. Dividends are a contractual obligation of the corporation, which must be paid at regular time intervals.
- T F 6. When capital stock is sold for a price higher than par value, the Capital Stock account is credited only for the par value of the shares sold.
- T F 7. In reference to question 6, any amount received in excess of the par value of the stock sold is recorded as a credit to the Retained Earnings account.
- T F 8. Dividends usually cannot be paid on common stock unless the regular dividend has been paid to preferred stockholders.
- T F 9. The expression **double taxation** refers to the fact that the net income of a corporation is taxed both by the state in which it is incorporated and by the federal government.
- T F 10. Dividends in arrears refer to bypassed preferred dividends which must be made up before any dividends may be paid on common stock.
- T F 11. An underwriter guarantees the issuing corporation a set price for a new issue of stock and then resells the stock to the investing public at a higher price.
- T F 12. The book value of a share of common stock usually approximates the market price of the stock, particularly for growth companies like Microsoft.
- T F 13. The purpose of a stock split is to decrease the market price per share.
- T F 14. A corporation's total stockholders' equity accounts do not change as a result of a stock split.

- T F 15. The purchase of treasury stock reduces both assets and stockholders' equity.
- T F 16. The reissuance of treasury stock for an amount in excess of its cost results in a gain to be reported in the income statement.
- T F 17. The reissuance of treasury stock for an amount less than its cost results in a financing cash inflow reported in the statement of cash flows.

Completion Statements

Fill in the necessary word to complete the following statements:

1. The owners of a corporation are _____, and their ownership of shares of stock is evidenced by a stock _____.
2. Among the disadvantages of the corporate form of organization are _____ and _____.
3. The two major sources of *equity* capital in a corporation are (a) the sale of _____ and (b) _____ earnings.
4. When common stock is issued at a price above par value, the _____ of the shares issued is _____ to the _____ account, and the excess is _____ to an account called _____.
5. Par value represents _____, which cannot be paid as dividends to stockholders.
6. A stock split reduces both the _____ value and the _____ price of a corporation's capital stock.
7. The purchase of treasury stock represents a cash _____ from financing activities, whereas the reissuance of treasury stock represents a cash _____ from financing activities.

Multiple Choice

Choose the best answer for each of the following questions and enter the identifying letter in the space provided.

- ___ 1. One of the following is *not* a characteristic of the corporate form of organization:
- a. Limited liability of shareholders.
 - b. Mutual agency.
 - c. Centralized authority.
 - d. Continuous existence.

- 2. Title to the assets of a corporation is legally held by:
 - a. The stockholders, jointly and severally.
 - b. The corporation, as a legal entity.
 - c. The president of the corporation in trust for the stockholders.
 - d. The board of directors, as trustees.

- 3. The *directors* of a corporation are responsible for:
 - a. Declaring dividends.
 - b. Maintaining stockholder records.
 - c. The day-to-day managing of the business.
 - d. Preparation of accounting records and financial statements.

- 4. One of the following is *not* an officer of a corporation:
 - a. Stock registrar.
 - b. Controller.
 - c. Secretary.
 - d. Treasurer.

- 5. For which of the following types of organizations would a creditor consider the balance sheet of the business most important to making a lending decision?
 - a. A sole proprietorship.
 - b. A general partnership.
 - c. A limited partnership.
 - d. A corporation.

- 6. Which of the following is *not* a characteristic of most preferred stock issues?
 - a. Preference as to dividends.
 - b. Participating clause.
 - c. Preference as to assets in event of liquidation.
 - d. No voting power.

- 7. Which of the following is *least* important in determining the fair market value of a share of stock?
 - a. Dividend rate per share.
 - b. Book value per share.
 - c. Investors' expectations as to future profitability of the company.
 - d. The par of stated value per share.

8. Which of the following does **not** increase the number of shares of capital stock outstanding?
- a. A stock split.
 - b. The reissuance of treasury stock.
 - c. A new public offering of capital stock by an underwriter.
 - d. The purchase of treasury stock.

Exercises

1. Listed below are eight technical accounting terms emphasized in this chapter.

Double taxation
Preferred stock
Common stock
Treasury stock

Legal capital
Corporation
Stock Split
Underwriter

Each of the following statements may (or may not) describe one of these technical terms. In the space provided below each statement, indicate the accounting term described, or answer "None" if the statement does not correctly describe any of the terms.

- a. Shares of a corporation's stock which have been issued and reacquired, but not canceled.

- b. An amount equal to the par value or stated value of capital stock issued.

- c. A disadvantage of the corporate form of organization.

- d. A bank or trust company retained by a corporation to maintain its records of capital stock ownership and make transfers from one investor to another.

- e. A classification of stock without voting rights.

- f. A classification of stock with voting rights.

- g. An increase in the number of shares outstanding with a corresponding decrease in the par value per share.

- h. A business organized as a legal entity separate from its owners.

4. Finday Corporation had total stockholders' equity of \$12,000,000 at January 1. During the year, the company engaged in the following activities:

April 19 Announced a 2-for-1 stock split on the 1,000,000 shares of its \$4 par value stock outstanding.

June 12 Purchased 5,000 shares of treasury stock at \$25 per share.

July 18 Reissued 2,000 shares of treasury stock at \$15 per share.

December 31 Reported income for the year of \$5,000,000.

Finday declared no dividends during the year. Total stockholders' equity reported in Finday's balance sheet dated December 31 will be:

\$ _____

